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Dear Andrew

Approval of Gas Exit Capacity Substitution and Revision Methodology Statement

On 28 March 2013, you submitted the Exit Capacity Substitution and Revision Methodology Statement (ExCS) for our approval. The submission was pursuant to Special Condition C8E paragraph 4 (the "Condition") of your gas transporter licence¹ (the "Licence"). Having regard to the exit capacity substitution objectives² set out in the Condition, and to our principal objective and statutory duties³, we have decided to approve the Statement.

This letter contains the reasons for our decision, and confirms the provisos in relation to the approval, as discussed with you.

Background

Exit capacity substitution is the process by which unsold baseline National Transmission System (NTS) exit capacity⁴ is moved from one or more NTS exit points (donor exit points) to meet customer demand for new NTS exit capacity at another NTS exit point (recipient exit point). Exit capacity substitution can avoid or defer the need for new investment to meet incremental capacity needs, and so help reduce the costs of gas transportation for gas customers. Exit capacity revision is the process by which exit capacity baseline levels are revised in the event that the release of new NTS entry capacity changes the availability of NTS exit capacity.

¹ For clarity, the submission was made under the licence in effect over the TPCR4 period; in the RIIO-T1 licence, the requirements previously contained in Special Condition C8E paragraph 4 have been replaced by Special Condition 9A.

² The exit capacity substitution objectives are set out in paragraph 4(b)(iii) of the Condition (Section 9A.5 of the licence in effect under RIIO-T1). They include: ensuring that exit capacity substitution is effected in a manner which is compatible with the physical capability of the pipeline system; avoiding material increases in the costs (including NTS exit constraint management costs in respect of NTS exit capacity previously allocated by the licensee to relevant shippers or DN operators) that are reasonably expected to be incurred by the licensee as a result of substituting NTS exit capacity; and, so far as is consistent with these objectives, facilitating effective competition between relevant shippers.

³ Set out in section 4AA of the Gas Act 1986, as amended.

⁴ NGG's capacity release obligations are defined in paragraph 3 of Special Condition C8E (Special Condition 9B, Part A of the licence in effect under RIIO-T1). Baseline exit capacity is the amount of capacity which the licensee is required to offer for sale at an NTS exit point.

You have a licence obligation to review the ExCS each year⁵. On 19 February 2013, you published (on your website) a consultation on the methodology to be applied from 1 June 2013. We understand that whilst you carried out the consultation in accordance with the licence in effect during the TPCR4 period, the methodology will apply in the RIIO-T1 period. As such, we note that the Statement is drafted according to the RIIO-T1 terminology and obligations (as set out under Special Condition 9A of the RIIO-T1 Licence, which applies from 1 April 2013⁶).

The consultation closed on 21 March 2013. Representations were received from one respondent, EDF Energy. The version of the Statement submitted to us on 28 March 2013 has been reviewed to take account of the issues raised in the consultation (as described in your Consultation Report⁷).

In the section below we summarise the changes proposed by you, and in the subsequent sections we set out the respondent's views and our own views on those changes.

Proposed changes to the statement – National Grid Gas (NGG)

You have consulted on the following changes to the Exit Capacity Substitution and Revision Methodology Statement –

- Exchange rate: proposed deletion of a section in paragraph 37, stipulating that the current 3:1 exchange rate limit (and the possible application of an exchange rate collar) will be reconsidered following initial application of the methodology, and may be amended or removed during the annual⁸ review of the methodology.
- Determining Substitutable Capacity: proposed amendment to the definition of Substitutable Capacity. In the existing statement, NGG must treat capacity that has previously been substituted to an NTS Exit Point as substitutable (paragraph 18 (d)). The paragraph has been amended so that NGG *may* consider this capacity for substitution, as opposed to the current text of *will* consider.
- Minor revisions, such as terminology and reference changes to align the ExCS to the RIIO-T1 final proposals.

Respondents' views – EDF Energy

EDF Energy was the only stakeholder to provide a response to the consultation. You addressed the points made by EDF Energy in its Formal Consultation Conclusions Report.

The issues raised related to:

- Exchange Rate: EDF Energy disagreed with the proposal to remove part of paragraph 37, arguing that the exchange rate limit and the possible application of an exchange rate collar should always be subject to revision, if appropriate. In response, you

⁵ For clarity, RIIO-T1 licence requires that ExCS is reviewed at least biennially.

⁶ This condition replaces the requirements which were formerly contained in Special Condition C8E paragraph 4 of the licence in effect under TPCR4 period.

⁷ A copy of this report is available at the following location on NGG's website:

<http://www.nationalgrid.com/NR/rdonlyres/C48F12CD-10DD-48A7-ABB9-F39E08392FC3/59856/03ExitSubstitutionConsultationReport2013.pdf>

⁸ The requirement to review ExCS annually has been changed under the RIIO-T1 licence; the review is now required to take place at least biennially.

drew attention to the fact that the entire methodology is reviewed periodically, judging it inappropriate to specifically highlight reconsideration of these two factors. Consequently, no changes to the proposed draft were made.

- Determining Substitutable Capacity: EDF Energy expressed concern at the change of wording from “will” to “may”, arguing that it enabled NGG to use its discretion over capacity substitution. You explained that, in your view, the presence of the word “will” could be considered to over-rule the other factors listed in paragraph 18, and that the proposed amendment remedied that irregularity. Consequently, no changes to the proposed draft were made.
- Incorrect referencing: EDF Energy was seeking additional clarity on references cited in paragraph 16; it noted that whilst the existing ExCS referred readers to a specific list of exit points and Revenue Drivers (Special Condition C8E paragraph 1 (d) of the transporter licence effective under TPCR4 period), the consultation draft directed the reader to Special Condition 9C of the licence under RIIO-T1, which sets out the obligation for NGG to produce a methodology to determine Revenue Drivers. You have consequently amended the above reference to Special Condition 5G Part D.
- Typographical and reference errors: you accepted all of the remaining formatting, editing and referencing changes put forward by EDF Energy.

Our view

Exit capacity substitution is intended to promote efficient use of the NTS. The capacity bookings made by NTS users under the exit capacity commercial arrangements⁹ provide you with important information about system use and investment needs. Where capacity which has not been booked can be substituted to meet demand for new capacity elsewhere on the system, this improves the efficiency of the NTS, and can help reduce the costs of gas transportation for gas customers.

We have carefully considered your ExCS methodology submission of 28 March 2013, as well as the Formal Consultation Conclusions Report. In our view, the methodology statement is consistent with your obligations under Special Condition C8E paragraph 4 of your licence. However, we identified areas requiring further attention from you to ensure straightforward and accurate interpretation of the methodology by its readers.

We have discussed our views with you, which you agreed with; you subsequently shared a “clean” version of the ExCS with us, incorporating the revisions we discussed to improve clarity. These changes affected neither the principle, nor intent of the methodology statement, and therefore we felt an informal re-submission was appropriate. However, for the purposes of transparency, our views and suggested revisions are outlined below.

- Exchange Rate: we accept your explanation for removing part of paragraph 37, and, in our view, these changes are appropriate. Your gas transporter licence requires you to review all aspects of the ExCS methodology at least biennially. For the avoidance of any doubt, both the exchange rate limit and the possible application on the exchange rate collar will be kept under review – amendments, substantiated by evidence, must be considered. As substitution requests are considered on an individual basis, this provides an opportunity to review the 3:1 exchange rate limit/application of the exchange rate collar if the need arises.

⁹ These arrangements are set out in Section B of Transportation Principal Document of the Uniform Network Code.

- Determining Substitutable Capacity: in our view, the change of wording in sub-paragraph 18 (d) from "will" consider to "may" does, albeit superficially, create the impression of allowing National Grid Gas a degree of discretion over how it chooses to define "substitutable capacity". In our subsequent discussions, you explained that your rationale for introducing this change was to remove a potential incongruity between sub-paragraph (d) and sub-paragraphs (k), (l) and (m).

You stated that previously substituted capacity which becomes unsold *will not* be substitutable capacity in the following cases:

- if a User or a Reservation Party has made a financial commitment in respect of works to provide incremental capacity or a new exit connection (sub-paragraph (k));
- in respect of Interconnector exit points the Technical Capacity¹⁰ of the downstream connected system at the interconnection point shall not be substitutable capacity (sub-paragraph (m)); or
- if the previously substituted capacity becomes unsold for years Y+3 and/or earlier, it will not be substitutable capacity (sub-paragraph (l)).

Your revisions to the proposed methodology draft include the following clarifying amendment, which we feel addresses the potential misconstruction.

"18 (d) Except where further provisions of this paragraph apply, capacity that has previously been substituted to an NTS Exit Point will be Substitutable Capacity".

- Imprecise referencing: where Exit Capacity applications result in a requirement for you to release Capacity at more than one NTS Exit Point, analysis of substitution opportunities must take account of Revenue Drivers at recipient Exit Points as stated in paragraph 26 of the ExCS. Whereas in the licence effective under TCPR4, Revenue Drivers were specified explicitly (Special Condition 8E paragraph 1 (d)), this is not the case in the current licence. Paragraph 26, as it was drafted, referred to Special Condition 5G Part D of the Licence. Whilst this reference is correct in the present situation – i.e. in the absence of an approved generic entry and exit revenue driver methodology – it will cease to be meaningful once that methodology comes into force. The next biennial review of ExCS methodology is due in spring 2015; therefore you must ensure that the references in place are specific and accurate.

Authority's decision

Following consideration of the documentation you provided pursuant to Special Condition C8E paragraph 4 of the Licence, and having regard to our principal objective and statutory duties, we approve the Gas Exit Capacity Substitution and Revision Methodology Statement as submitted on 28 March 2013, and with the revisions submitted to us on 15 May 2013.

Yours sincerely



Andrew Burgess
Associate Partner, Transmission and Distribution Policy

¹⁰ "Technical Capacity" is as defined in Article 2 of Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and means "the maximum firm capacity that the transmission system operator can offer to the network users, taking account of system integrity and the operational requirements of the transmission network".